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C O N F I D E N T I A L SECTION 01 OF 02 LA PAZ 001596

SIPDIS

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TAGS: ECON PGOV PET EINV BL ENRG EMIN
SUBJECT: BOLIVIA: NEW TAX REGIME COMPLICATES FINANCES FOR
PRIVATE FIRMS

Classified By: A/EcoPol Chief Joe Relk for reasons 1.4 (b,d).

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Summary
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¶1. (C) The ramifications of a change in tax law decreed December 2007 are only now becoming apparent in many sectors of the Bolivian economy. The two-part decree first dictates that companies adjust their asset values for inflation and declare any gain in value as earnings. Since the companies must pay taxes on those earnings, the law amounts to a tax on inflation. Secondly, the decree requires companies to adjust foreign loan liabilities by changes in the exchange rate and declare any savings due to the appreciating national currency as earnings. In other words, a company with lower loan payments due to a falling dollar must pay taxes on those savings. The legal changes will hurt companies with large asset bases and outstanding foreign loans, in particular mining, electricity, and cement. Mining executives fear that the new system could result in insupportable levels of taxation and could actually eventually amount to expropriation through taxation. End summary.

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A Tax on Inflation
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¶2. (U) The December 2007 decree on financial statements will seriously increase the tax burden on companies with large fixed assets in an inflationary period. The decree dictates that companies must recalculate asset values based on variations in Housing Development Units (UFVs), an inflation index composed of materials used in construction. Moreover, companies must declare any resulting rise in asset values as earnings and pay taxes on those earnings. This amounts to a tax on inflation. For example, a given company with assets worth $100 million could undertake no activity in a given year, but with a 12 percent rise in inflation (the rise in UFVs last year in Bolivia), it would owe taxes on $12 million worth of earnings.

¶3. (C) Humberto Rada, General Manager of Newmont's Inti Raymi Mining Company and President of the Bolivian Mining

Association told Econoffs that the mining sector would be the hardest hit, but electricity and cement companies would also be heavily impacted. Bolivian corporate taxes are paid on a rolling basis, with mining companies reporting in September. Rada said that the cement industry had already paid in June, and that the accounting changes had doubled the tax burden of a large La Paz cement producer. Rada is currently trying to rally support for a change in the law before taxes for mining are due.

¶4. (C) The effects on the hydrocarbon sector are negligible because of limited fixed assets in upstream activities. Pipeline operators would be the exception but Jorge Kauer, General Manager of Transierra, told us that due to tax particulars applied to the pipeline companies, the new changes in the tax law would not affect his company in the short term.

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The Exchange Rate and Payment of Foreign Loans
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¶5. (C) The second change in the tax law adjusts foreign loan repayments by exchange rate fluctuations and declaring gains as income. Under the new law a company must declare as earnings any decrease in foreign currency loan value due to local currency appreciation. This change will have the greatest impact on companies with large foreign loans; again, the mining sector will likely be the hardest hit. On the other hand, the banking sector has benefited from this law.

Since banks are on the flip side of the coin, they are able to claim as losses any reduction in loan value due to exchange rate changes. As a result, banks are able to deduct these paper losses from their income and pay less tax. These conflicting interests across the sectors have resulted in a stalemate within the national business chamber and have eliminated the body as an effective lobbyist on the part of the productive industries.

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San Cristobal: One More Blow Against Their Business
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¶6. (C) Gerardo Garrett, Vice President at APEX's San Cristobal mine told us that the new tax code is just one more blow to the profitability and viability of the operation. San Cristobal's situation perhaps best illustrates what these new regulations could mean to the bottom line. As an example, the Mining Association's Rada estimated that San Cristobal had about $900 million in loans and about the same amount in assets. This would mean that as part of the inflation adjustment, the company would have to declare an additional $108 million in earnings. Additionally, with a 10 percent appreciation of the national currency, savings on the loans would generate an additional $90 million in declared earnings. The company would then owe a 37.5 percent income tax on these amounts, which, taken together would add up to $74 million in additional taxes - - strictly on paper gains.

¶7. (C) The fear across the mining industry is that an inability to pay such exorbitant taxes will result in the nationalization of their operations (Note: Mining, electric, and cement interests are frequently mentioned as targets for nationalization. End note). The changes in the tax law originated in a suggestion by the National Technical Auditing and Accounting Council (CTNAC). Rada does not believe that the Morales administration passed these suggestions into law with the intent of "expropriation by taxation," but that the government now realizes the tax changes' potential as a nationalization tool. As a result, even though the CTNAC is now considering reversing its recommendations, it is unlikely that the Morales administration would agree to reverse the law.
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